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INFO AMEMBASSY DUBLIN

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF IRELAND, OCTOBER 6, 1976

REF: EDR(76)23

1. SUMMARY: IN REFDOC CIRCULATED FOR OCT 6 EDRC REVIEW OF IRELAND, SECRETARIAT PAINTS RATHER GLOOMY PICTURE FOR 1976: REAL GNP GROWTH OF 2-1/2-3 PERCENT; CONSUMER PRICE INCREASE OF 19 PERCENT; WIDENING OF CURRENT ACCOUNT DEFICIT TO 160 MILLION POUNDS FROM 15 MILLION POUNDS IN 1975; AND RISING UNEMPLOYMENT. ACCORDING TO SECRETARIAT, OUTLOOK FOR 1977 IS UNCERTAIN AND WILL DEPEND PRIMARILY ON OUTCOME OF NEGOTIATIONS (NOW IN PROGRESS) BETWEEN GOVERNMENT, BUSINESS AND LABOR REGARDING SOCIAL AND ECONOMIC STRATEGY FOR NEXT TWO YEARS AND ON TERMS OF NEW NATIONAL PAY AGREEMENT (NPA) WHICH WOULD SUCCEED CURRENT INTERIM PAY ARRANGEMENTS. THUS, SECRETARIAT DOES NOT GIVE SPECIFIC FORECASTS FOR 1977 BUT FORESEES CONTINUA-

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TION OF SLOW GROWTH, RAPID INFLATION AND DETERIORATION

OF CURRENT ACCOUNT. SECRETARIAT NOTES THAT IRISH DEMAND MANAGEMENT POLICIES SEVERELY CONSTRAINED: FISCAL POLICY BY LARGE PUBLIC SECTOR BORROWING REQUIREMENT; MONETARY POLICY BY CLOSE MONETARY TIES TO U.K. AND BY FIXED PARITY BETWEEN IRISH AND BRITISH POUNDS. SECRETARIAT STRESSES THAT CUTTING EDGE OF IRISH ECONOMIC POLICY MUST, THEREFORE, BE ACTIVE GOI EFFORT TO REDUCE GROWTH OF NOMINAL INCOMES. FAILURE TO REDUCE INFLATION WOULD IMPEDE EXPORT/INVESTMENT-LED GROWTH SECRETARIAT DEEMS ESSENTIAL FOR IRELAND, WOULD RESULT IN DANGEROUS INCREASE IN CURRENT ACCOUNT DEFICIT OVER MEDIUM TERM, AND WOULD MAKE IT IMPOSSIBLE TO ATTAIN GROWTH RATE HIGH ENOUGH TO ABSORB EXPECTED INCREASE IN LABOR SUPPLY. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS/ QUESTIONS WHICH COULD BE USEFULLY POSED AT REVIEW. FOR DUBLIN: MISSION WOULD WELCOME EMBASSY COMMENTS AS WELL AS PARTICIPATION BY EMBASSY REP AT REVIEW.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: IRISH RECOVERY, WHICH SECRETARIAT ESTIMATES TO HAVE BEGUN IN MID-1975, WAS LED BY RAPID GROWTH IN CONSUMER SPENDING AND BY SURGE IN INDUSTRIAL EXPORTS. GNP GROWTH TAPERED OFF IN SECOND HALF OF 1976 AS CONTINUED RAPID GROWTH IN INDUSTRIAL EXPORTS WAS PARTLY OFFSET BY SLOWER GROWTH OF PRIVATE CONSUMPTION. REAL INVESTMENT SPENDING FELL BY 5.5 PERCENT IN 1975. SECRETARIAT EXPECTS FURTHER DECLINE IN FIXED INVESTMENT SPENDING IN 1976, WITH INCREASE IN PUBLIC INVESTMENT BEING MORE THAN OFFSET BY DECLINE IN PRIVATE SECTOR. SECRETARIAT FORECASTS STRONG POSITIVE CONTRIBUTION TO 1976 GDP FROM STOCK MOVEMENTS, BUT NEGATIVE CONTRIBUTION FROM REAL FOREIGN BALANCE, GIVING ESTIMATE OF 2-1/2-3 PERCENT REAL GNP GROWTH FOR YEAR.

3. WAGES AND PRICES: SECRETARIAT FORECASTS 19 PERCENT INCREASE IN CONSUMER PRICES FOR 1976 AFTER 21 PERCENT INCREASE IN 1975, AND IDENTIFIES RAPID INCREASE IN NOMINAL WAGES AS INFLATION'S DRIVING FORCE. IN EFFORT TO BREAK WAGE COST/INFLATION CYCLE, GOI OPENED NEGOTIATIONS WITH BUSINESS AND LABOR IN EARLY 1976 WITH VIEW TOWARD SECURING LATTER'S ACCEPTANCE OF A PAY PAUSE FROM LIMITED OFFICIAL USE

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MID-1976 (EXPIRATION OF 1975 NPA) TO END OF YEAR. NEGOTIATIONS, FOLLOWING REJECTION PAY PAUSE BY ORGANIZED LABOR, LED TO ACCEPTANCE OF "INTERIM" ARRANGEMENT (AGREED BY GOI, BUSINESS AND LABOR IN SEPTEMBER, 1976) GOVERNING WAGE INCREASES PENDING NEGOTIATION OF NEW NPA. ACCORDING TO SECRETARIAT, "INTERIM" AGREEMENT IMPLIES THAT AVERAGE EARNINGS WILL RISE BY 19-20 PERCENT DURING SECOND HALF OF 1976. WITH THIS INCREASE, TOGETHER WITH

INCREASES REGISTERED IN FIRST HALF OF YEAR AND WITH
SOME RECOVERY-INDUCED INCREASE IN PRODUCTIVITY, IRISH
UNIT LABOR COSTS COULD RISE BY 17 PERCENT FOR 1976 AS A
WHOLE. SECRETARIAT ALSO ESTIMATES THAT UNDERLYING RATE
OF INFLATION IN IRELAND IS 17 PERCENT. SECRETARIAT
STRESSES THAT SHARP INCREASE IN IRISH LABOR COSTS HAS
HAD NEGATIVE EFFECT ON FOREIGN DIRECT INVESTMENT INFLOWS

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WHICH HAD BEEN A MAJOR FACTOR IN INCREASING DYNAMISM OF
IRISH EXPORT SECTOR.

4. EMPLOYMENT: UNEMPLOYMENT CONTINUED TO INCREASE IN
1976 (THOUGH LESS RAPIDLY THAN IN 1975), WITH REGISTERED
UNEMPLOYED REACHING 12.5 PERCENT OF LABOR FORCE AT MID-
YEAR, THE HIGHEST IN 30 YEARS. MORE DISTURBING, IN
SECRETARIAT VIEW, IS FACT THAT TOTAL JOB CREATION HAS
BEEN DECLINING SINCE 1973 PEAK; SECRETARIAT ESTIMATES
THAT JOB DISMISSALS WERE DUE TO CYCLICAL AND STRUCTURAL
FACTORS, IN ROUGHLY EQUAL SHARES. SECRETARIAT SEES

REDUCTION OF UNEMPLOYMENT AS PROBLEM OF OVERRIDING IMPORTANCE FOR GOI IN MEDIUM TERM.

5. OUTLOOK FOR 1977: SECRETARIAT DOES NOT PRESENT SPECIFIC FORECASTS FOR 1977, SINCE DEVELOPMENTS IN THAT YEAR WILL BE HEAVILY INFLUENCED BY OUTCOME OF TRIPARTITE NEGOTIATIONS (NOW IN PROGRESS) ON FUTURE ECONOMIC AND SOCIAL STRATEGY. NEVERTHELESS, SECRETARIAT FEELS THAT UNEMPLOYMENT WILL RISE AND THAT INFLATION WILL REMAIN LIMITED OFFICIAL USE

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STRONG -- WHATEVER THE OUTCOME OF THE CURRENT WAGE NEGOTIATIONS.

6. CURRENT ACCOUNT: FOR 1976, SECRETARIAT FORECASTS IMPROVEMENT IN IRISH TERMS OF TRADE BUT UNFAVORABLE VOLUME MOVEMENTS IN EXPORTS AND IMPORTS AND CURRENT ACCOUNT DEFICIT OF 160 MILLION POUNDS (VS 15 MILLION POUNDS IN 1975). SECRETARIAT DOES NOT EXPECT IRISH TO HAVE DIFFICULTY FINANCING 1976 DEFICIT (IRISH SHARE OF EEC LOAN WILL PROVIDE MOST OF NEEDED FINANCE), BUT NOTES THAT ACCUMULATED EXTERNAL PUBLIC-SECTOR DEBT STOOD AT 1.1 BILLION POUNDS IN 1976 AND THAT REDUCTION OF CURRENT ACCOUNT DEFICIT OVER MEDIUM TERM WOULD BE DESIRABLE.

7. FISCAL AND MONETARY POLICY: SECRETARIAT EMPHASIZES THAT LARGE PUBLIC-SECTOR BORROWING REQUIREMENT HAS ESSENTIALLY PRECLUDED THE USE OF FISCAL POLICY AS DEMAND MANAGEMENT TOOL DURING RECESSION. CLOSE MONETARY LINK TO U.K. THROUGH FIXED PARITY BETWEEN IRISH AND BRITISH POUNDS HAS LARGELY PREVENTED GOI FROM PURSUING EVEN MODERATELY INDEPENDENT MONETARY POLICY. SECRETARIAT ALSO NOTES THAT LARGE PUBLIC-SECTOR DEFICIT PLACED ADDITIONAL CONSTRAINT ON FLEXIBLE USE OF MONETARY POLICY IN 1976.

8. BASED ON ANALYSIS PRESENTED REFD0C, SECRETARIAT SUGGESTS THAT EDRC REACH FOLLOWING CONCLUSIONS:

(1) SOLUTION TO MANY PROBLEMS BESETTING IRISH ECONOMY LIES IN CURBING INFLATION. A SUBSTANTIAL REDUCTION IN RISE OF NOMINAL INCOMES IS PREREQUISITE FOR IMPROVING COMPETITIVENESS, FOR ACHIEVING EXPORT/INVESTMENT-LED GROWTH IN MEDIUM TERM, AND THUS FOR BRINGING ABOUT SIGNIFICANT REDUCTION IN UNEMPLOYMENT;

(2) DESPITE OUTLOOK FOR SLLLOW GROWTH IN 1977, GENERAL REFLATIONARY DEMAND MANAGEMENT POLICY SHOULD BE AVOIDED. INCREASED PUBLIC SPENDING ON INFRASTRUCTURE INVESTMENT WOULD BE APPROPRIATE, BUT IMMEDIATE STEPS

SHOULD BE TAKEN (ON THE SPENDING SIDE) TO REDUCE
PUBLIC-SECTOR CURRENT DEFICIT AND HENCE OVERALL PUBLIC-
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SECTOR BORROWING REQUIREMENT.

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9. COMMENT: (A) MISSION AGREES WITH CONCLUSION OF
SECRETARIAT ANALYSIS THAT REDUCTION IN NOMINAL WAGE
INCREASES IS ESSENTIAL. IN RECENT PAST, GOI HAS BEEN
INEFFECTIVE IN SECURING MODERATION ON PART OF LABOR. IT
IS DIFFICULT TO SEE HOW GOI COULD INCREASE ITS NEGO-
TIATING LEVERAGE. MISSION WOULD EXPLORE THIS QUESTION
WITH IRISH REP AND WITH SECRETARIAT. (B) SECRETARIAT
ANALYSIS OF IRISH MEDIUM-TERM OUTLOOK CONCLUDES THAT TO

REACH "FULL EMPLOYMENT" (ASSUMED TO BE 4 PERCENT) BY 1986 IRISH REAL GDP WILL HAVE TO GROW BY 6.25 PERCENT ANNUALLY. THIS GROWTH RATE WOULD HAVE TO BE SUPPORTED BY INVESTMENT GROWTH OF 12 PERCENT PER YEAR AND 18 PERCENT ANNUAL INCREASE IN MANUFACTURING EXPORTS (IN CONTRAST WITH PROJECTED 9 PERCENT ANNUAL GROWTH IN IRISH EXPORT MARKETS). SECRETARIAT'S "GROWTH SCENARIO TO 1980" PUTS IRISH REAL GDP GROWTH AT 4 PERCENT PER YEAR BETWEEN 1975 AND 1980. IT ALSO IMPLIES THAT IRISH COULD LOSE EXPORT MARKET SHARES BETWEEN 1975 AND 1980 IN CONTRAST TO 9 PERCENT ANNUAL GROWTH IN SHARES IMPLIED LIMITED OFFICIAL USE

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IN REFD. "GROWTH SCENARIO" ILLUSTRATES WHAT MIGHT BE POSSIBLE TO ACHIEVE WITH "SKILLFUL ECONOMIC MANAGEMENT;" THUS COMPARISON CURRENT TRENDS AND PROSPECTS WITH "SCENARIO" SUGGESTS THAT HERCULEAN EFFORT WOULD SEEM TO BE NECESSARY FOR IRELAND TO MAKE STEADY PROGRESS TOWARD "FULL EMPLOYMENT" OVER MEDIUM TERM. MISSION PLANS TO RAISE THESE ISSUES AT EDRC MEETING.
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